

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

13 March 2009

Dear Sirs

“Revisions to the Basel II Market Risk Framework” and “Guidelines for Computing Capital for Incremental Risk in the Trading Book”

Standard Chartered Bank would like to make the following comments in relation to the above consultations:

General observations

It is widely accepted that capital requirements must be adjusted, but this alone will not prevent future crises: systemic risk, liquidity risk and accounting policies must each be addressed in order to improve financial stability.

The danger now is that policy makers act too quickly, too strongly and indiscriminately, creating many unintended consequences.

Future regulatory architecture must address the weaknesses that caused the crisis but must also avoid the trap of impeding general bank trading activities by universally increasing the cost of managing risk for banks and corporations alike.

The existing VaR framework remains an appropriate way of measuring risk for positions in liquid instruments that can be valued accurately. The Stress VaR proposal should be abandoned. It risks damaging types of trading activities that have in no way contributed to the current financial crisis.

Regulators must:

- assess concentrations of risk across the banking industry in order to identify systemic risk;
- take both market liquidity and funding liquidity into account for capital calculation purposes. Such measures will incentivise banks to fund assets in line with expected holding period, as well as reduce the risk of forced liquidation due to restricted funding conditions;

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- align accounting policies and regulatory risk capital assessment. Fair value treatment and VaR are both based on the assumption of liquid underlying markets. In the case of illiquid markets, both Fair Value accounting and VaR-based capital charges should be adjusted using the same principles; and
- have a stronger focus on the delineation of the trading and banking books. Tighter governance would prevent both the accumulation of illiquid assets in trading books with inappropriate capital treatment and capital arbitrage from the reclassification of assets between trading and banking books.

Most importantly it needs to be recognised that not everything is broken. Incremental adjustments can go a long way to restoring global financial stability without creating further shocks to the system.

Market Risk Framework

Stress VaR does not meet the use test and dilutes the effectiveness of VaR by creating a duplicate risk metric. The same end – higher capital - could be achieved at lower implementation cost by other means, for example, by simply increasing the VaR “multiplication factor”.

Higher capital requirements are not in themselves better capital requirements. Increasing the capital requirement uniformly across all trading book activity could have the unintended consequence of reducing market liquidity by making it uneconomic for participants to trade in some markets. Increasing the capital requirement across the trading book also risks accelerating the difficult process of deleverage that is under way across the banking system.

The Framework should focus on achieving the “right” capital requirement for a particular portfolio of risks. The right capital requirement ought to be determined with greater emphasis on, firstly, increasing the representation of risks within VaR and, secondly, responding appropriately to tail and liquidity risks outside of VaR. The right capital requirement will not necessarily be as much as double the existing VaR based capital requirement for all asset classes. The right capital requirement should discriminate between those classes of assets where VaR has been found to be a poor predictor of losses and those where it has not.

The right capital requirement should also start with the assumption that VaR is the appropriate default method of calculating capital for internationally active banks. The compliance burden of initial and ongoing supervisory approval for the use of VaR models in regulatory capital should be reduced. This would help to offset the additional burden of addressing tail and liquidity risk. Such an approach would be prudentially sound where the gap between standardised and VaR based capital requirements is diminished. It would also free up supervisory resources to focus on the comparative assessment of banks’ risk exposures.

Incremental Risk Charge

The scope of the IRC is unclear in respect of equity.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Doris Honold', with a stylized flourish at the end.

Doris Honold
Group Head, Market Risk